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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 282

JOHN L. FLYNN, TRUSTEE OF LITHALOYS CORPORATION AND LITHALOYS CORPORATION, DEBTOR, PETITIONERS

v.

RECONSTRUCTION FINANCE CORPORATION

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RECONSTRUCTION FINANCE CORPORATION IN OPPOSITION

OPINIONS BELOW

The opinion of the United States District Court for the Southern District of New York (R. 15-20) is not reported. The opinion of the United States Court of Appeals for the Second Circuit (R. 28-32) is not yet reported.

JURISDICTION

The judgment of the Court of Appeals was entered on June 8, 1949 (R. 32). The petition for

writ of certiorari was filed on August 19, 1949. The jurisdiction of this Court is invoked under 28 U. S. C. 1254(1).

QUESTION PRESENTED

Whether Section 3 of the Act of May 25, 1948, 62 Stat. 262, 15 U. S. C., Supp. II, 603(a), entitles the Reconstruction Finance Corporation to a priority in payment, in a pending Chapter X bankruptcy reorganization proceeding, for debts owed to Defense Plants Corporation and Smaller War Plants Corporation which were transferred to Reconstruction Finance Corporation upon the dissolution of those corporations.

STATUTE INVOLVED

Section 3(a) of the Reconstruction Finance Corporation Act as amended by Section 3 of the Act of May 25, 1948, 62 Stat. 262, 15 U. S. C., Supp. II, 603(a), provides in pertinent part as follows:

> * * * Debts due the Corporation, whether heretofore or hereafter arising, shall not be entitled to the priority available to the United States pursuant to section 3466 of the Revised Statutes (U.S.C., title 31, sec. 191) except that the Corporation shall be entitled to such priority with respect to debts arising from any transaction pursuant to any of the following Acts or provisions in effect at any time: Sections 5d (1) and 5d (2) of the Reconstruction Finance Corporation Act added by section 5 of the Act entitled "An Act to authorize the purchase by the Reconstruction Finance Corporation of stock of Federal home-loan banks; to amend the Reconstruction

Finance Corporation Act, as amended, and for other purposes", approved June 25, 1940 (54 Stat. 573); sections 4 (f) and 9 of the Act entitled "An Act to mobilize the productive facilities of small business in the interests of successful prosecution of the war, and for other purposes", approved June 11, 1942 (56 Stat. 354, 356); section 2 (e) of the Emergency Price Control Act of 1942 (56 Stat. 26); the Surplus Property Act of 1944 (58 Stat. 765 and the following); sections 11 and 12 of the Veterans' Emergency Housing Act of 1946 (60 Stat. 214, 215); and section 403 of the Sixth Supplemental National Defense Appropriation Act (56 Stat. 245).

STATEMENT

The application of Reconstruction Finance Corporation in the District Court for the Southern District of New York for an order, allowing its claims against the debtor in reorganization as priority claims, discloses the following facts, which are undisputed:

In June, 1946, Lithaloys Corporation, the debtor, filed a voluntary petition for reorganization pursuant to the provisions of Chapter X of the Bankruptcy Act. The District Court approved the petition and appointed petitioner, John L. Flynn, as trustee (R. 4). In October, 1946, a plan of reorganization was proposed by a creditor, predicated upon the insolvency of the debtor and providing simply for the reduction of the assets of the debtor to cash for distribution to creditors

(R. 4). On October 30, 1946, the District Court ordered all proofs of claim to be filed on or before November 18, 1946 (R. 4). The plan of reorganization did not provide for separate classification or treatment of creditors asserting general priority, and the order of October 30, 1946, did not require unsecured creditors to set forth any general priority claimed (R. 5).

On November 18, 1946, the final filing date allowed by the District Court, RFC filed the claims in issue. The first claim represented the balance due on a secured loan owed by the debtor to Smaller War Plants Corporation and transferred to RFC upon the dissolution of SWPC, by Executive Order No. 9665, dated December 27, 1945, 3 C. F. R., 1945 Supp., p. 166. (R. 5.) In May, 1947, this claim was reduced by the amount realized on the security (R. 6). The second claim represented a debt arising out of transactions between the debtor and Defense Plants Corporation, which was transferred to RFC, upon the dissolution of DPC by the Act of June 30, 1945, 59 Stat. 310 (R. 5). The claim was later amended in January, 1948, to include a small sum for the value of personal property leased to the debtor by DPC (R. 6).

On January 3, 1947, the District Court entered an order approving the plan of reorganization, as amended. *Inter alia,* the order found the debtor to be insolvent and amended the plan by providing for payment of all priority claims prior to the distribution to general creditors. (R. 5-6.) On Feb-

ruary 14, 1947, the District Court confirmed the plan of reorganization approved on January 3, 1947, and reserved jurisdiction (R. 6).

On May 25, 1948, Public Law 548, 80th Cong., 2d sess., 62 Stat. 262, which amended the Reconstruction Finance Corporation Act, became effective. Section 3 thereof, *supra*, pp. 2-3, provided in part that "Debts due the Corporation, whether heretofore or hereafter arising, shall not be entitled to the priority available to the United States pursuant to section 3466 of the Revised Statutes (U.S.C., title 31, sec. 191) except that the Corporation shall be entitled to such priority with respect to debts arising from any transaction pursuant to any of the following Acts or provisions in effect at any time: * * *." The enumerated Acts included "* * * sections 4 (f) and 9 of the Act entitled 'An Act to mobilize the productive facilities of small business in the interests of successful prosecution of the war, and for other purposes', approved June 11, 1942 (56 Stat. 354, 356 [50 U. S. C. App. 1104(f), 1109])," under which the claims here involved arose.

On September 2, 1948, pursuant to Public Law 548, RFC filed a further amendment claiming priority on $185,636.01 of its original claims (R. 7). As of that date, no distribution under the plan of reorganization had been made to any of the creditors and the plan had not been consummated in any respect other than the liquidation of the debtor's assets (R. 9). On September 10, 1948, the Trus-

tee rejected this last amendment on the ground that the time for filing claims had expired on November 18, 1946, and that the rights of creditors had long since been fixed under the plan of reorganization (R. 8, 10-11). RFC then filed its petition in the District Court for an order allowing its claims as priority claims (R. 4-14). The District Court denied the motion (R. 21), holding that R. S. 3466, 31 U.S.C. 191 (the basic priority statute), did not apply and that Section 3 of the Act of May 25, 1948, did not operate retroactively (R. 15-20). On appeal the court below reversed (R. 32); it held that Section 3 of the Act of May 25, 1948, clearly provided that it should apply retrospectively and, in the light of that holding, it concluded that it was unnecessary to pass upon the applicability of R. S. 3466 to the claims here involved.

ARGUMENT

1. The intention of Congress that Section 3 of the Act of May 25, 1948, *supra,* pp. 2-3, be retroactive in operation is manifest from the plain language of the statute. Section 3 provides as follows:

> * * * Debts due the Corporation, whether heretofore or hereafter arising, shall not be entitled to the priority available to the United States pursuant to section 3466 of the Revised Statutes (U. S. C., title 31, sec. 191) except that the Corporation shall be entitled to such priority with respect to debts arising from any transaction pursuant to any of the following Acts or provisions in effect

> at any time: * * * sections 4 (f) and 9 of the Act entitled "An Act to mobilize the productive facilities of small business in the interests of successful prosecution of the war, * * *."

The Congressional mandate is unequivocal. The Statute specifically encompasses "Debts * * * whether heretofore or hereafter arising, * * *." No limitation is imposed as to the time when such debts, as a class, accrued, either for the purpose of excluding them from or including them within the priority conferred by "section 3466 of the Revised Statutes," and the specified priority applies unqualifiedly with respect to debts arising "from any transaction" pursuant to the enumerated Acts.

Reference to the legislative history of Section 3 confirms the conclusion that RFC is entitled to a priority for the debts here involved. Under R. S. 3466 (31 U.S.C. 191), which provides in part that "Whenever any person indebted to the United States is insolvent * * * the debts due the United States shall be first satisfied; * * *," two divergent lines of decision as to whether governmental agencies and corporations are entitled to the priority due the United States have emerged.[1] Compare *Sloan Shipyards Corp.* v. *United States Fleet Corp.*, 258 U. S. 549; *United States* v. *Marxen*, 307 U. S. 200, with *United States* v. *Emory*, 314 U. S. 423; *Illinois* v. *United States*, 328 U. S. 8;

[1] The court below found it unnecessary, for the purpose of this litigation, to decide whether RFC was entitled to priority under R. S. 3466 (R. 30).

Cherry Cotton Mills v. *United States,* 327 U. S. 536; *United States* v. *Remund,* 330 U. S. 539. In submitting S. 2287 (later enacted into the statute here involved), the Senate Committee on Banking and Currency included in Section 3 thereof a provision to clarify, as to RFC, the confusion existing with respect to R. S. 3466. The accompanying report states that (S. Rep. 974, 80th Cong., 2d Sess., p. 20):

> Because of recent United States Supreme Court decisions it may be that RFC is entitled under the present law to the same priority in bankruptcy which is enjoyed by the United States. The Committee believes that RFC should not have this priority with respect to the recovery of funds advanced under its regular lending operations. A sentence is therefore added to this section *which will remove that priority* except with respect to obligations owed to RFC as a result of certain of its war time activities. (Emphasis added.)

This legislative purpose was reiterated on the floor of the Senate by Senator Buck, chairman of the special subcommittee of the Senate Committee on Banking and Currency which conducted the inquiry into the operations of RFC pursuant to S. Res. 132, 80th Cong., 1st Sess., and reported out S. 2287. Explaining the aim of Section 3, Senator Buck commented (94 Cong. Rec. 4108):

> * * * Because of a recent Supreme Court decision, a question has arisen as to whether

> RFC may not be entitled to the priority in bankruptcy which is available to the United States. The Committee believes that RFC should not have such priority with respect to debts arising from its normal lending activities. A provision has been included in this section *which will eliminate that priority* except with respect to debts arising under the specific war powers which are designated therein. * * * [Emphasis added.]

To the same effect, see H. Rep. 1836, 80th Cong., 2d Sess., p. 11. It is evident from these statements that Congress thought it was limiting an existing right to priority and not creating new ones. But it also recognized that this Court had not decided the specific problem, and it therefore employed language which would leave no room for doubt. It retroactively denied priority to certain classes of claims and at the same time retroactively granted priority to other classes. As the court below points out, the syntax of the act bears out this intention. "The general clause, *divesting* the R. F. C. of governmental priority, precedes the exceptions, *preserving* that priority in certain instances" (R. 30).

A retroactive interpretation of Section 3 is further compelled by the fact that any other reading would defeat its very purpose. The debts here involved accrued to the Defense Plants Corporation and the Smaller War Plants Corporation under one of the acts enumerated in Section 3 herein, namely "sections 4 (f) and 9 of the Act

entitled 'An Act to mobilize the productive facilities of small business in the interests of successful prosecution of the war, and for other purposes,' " 56 Stat. 354, 356, 50 U.S.C. App. 1104(f), 1109; and both DPC and SWPC were dissolved more than two years prior to the enactment of Section 3(a), and all of their assets were transferred to RFC (Act of June 30, 1945, 59 Stat. 310; Executive Order No. 9665, 3 C.F.R., 1945 Supp., p. 166). If Section 3 is not to be applied retroactively, the preservation of priority rights to RFC in claims arising under the exercise of those wartime powers by DPC and SWPC is patently meaningless.

2. Although, as petitioner points out, the general rule is that the rights of creditors in bankruptcy are determined as of the filing of a petition (Pet. p. 13), there is certainly no constitutional bar to legislation which changes existing priorities. See *Kuehner* v. *Irving Trust Co.*, 299 U. S. 445, 452; *Carpenter* v. *Wabash Ry. Co.*, 309 U. S. 23, 28; *City of Chelsea* v. *Dolan*, 24 F. 2d 522 (C.A. 1), certiorari denied, 277 U. S. 606; *Adams* v. *Bowen*, 46 F. 2d 294 (C.A. 1); *In re Inland Dredging Corp.*, 61 F. 2d 765 (C.A. 2), certiorari denied, 288 U. S. 611; *In re Old Algiers*, 100 F. 2d 374 (C.A. 2); *In re William Akers, Jr., Co.*, 31 F. Supp. 900 (E.D. Pa.), reversed on other grounds, 121 F. 2d 846 (C.A. 3); *In re Jay & Dee Store Co.*, 37 F. Supp. 989 (E.D. Pa.); *In re Prima Co.*, 88 F.

2d 785 (C.A. 7); *In re Chicago, R. I. & P. Ry. Co.*, 90 F. 2d 312 (C.A. 7). And on the facts herein, there would seem to be no equitable ground for denying RFC priority. Although the application for a priority came after the time for filing claims had expired and a plan of liquidation had been confirmed, no distribution had been actually made to creditors and the District Court had expressly retained jurisdiction to modify its order confirming the plan of liquidation. Moreover, the plan simply contemplated the reduction of the assets of the debtor to cash for distribution to creditors, providing, *inter alia,* for payment of all priority claims prior to general distribution. Petitioner has made no showing of any action, prejudicial to participating creditors, which resulted from the failure of RFC to assert its priority at an earlier date. We can only conclude therefore, as did the court below, that "We cannot see that the orderly proceedings in bankruptcy will be disturbed if the priority is allowed, and we do not find the authorities cited by respondent [petitioner herein—Pet. pp. 13-15] to require the contrary" (R. 31).

3. The same problem was considered by the Court of Appeals for the Seventh Circuit in *In re Temple,* 174 F. 2d 145, in which that court similarly upheld the claim of R. F. C. to priority under Section 3.

CONCLUSION

The decision below is correct, and there is no conflict of decisions. It is respectfully submitted, therefore, that the petition for a writ of certiorari should be denied.

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